

ASEAN-U.S. INITIATIVE

**Assessment and Recommendations
for Improved Economic Relations**



Joint Final Report

Co-ordinated by

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Michael Plummer Narongchai Akrasanee



East-West Center
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Institute of Southeast Asian Studies
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Cataloguing Data

ASEAN-U.S. initiative: assessment and recommendations for improved economic relations: joint final report / co-ordinated by Seiji Naya ... [et al.].

"Prepared under the overall guidance of the Resource Systems Institute, East-West Center, Honolulu, and the Institute of Southeast Asian Studies, Singapore ..."

1. ASEAN countries—Foreign economic relations—United States.

2. United States—Foreign economic relations—ASEAN countries.

I. Naya, Seiji.

II. East-West Center. Resource Systems Institute.

III. Institute of Southeast Asian Studies (Singapore)

HF1592.5 U6A84 1989

ISBN 981-3035-22-6

Printed in Singapore by Kin Keong Printing Co. Pte. Ltd.

PREFACE

A joint effort by U.S. and ASEAN researchers, the study on the ASEAN-U.S. Initiative (AUI) commenced in July 1988, and was completed within nine months. Its goal is to assess the current ASEAN-U.S. economic situation and provide recommendations for future policy action to enhance bilateral economic relations. Although the policy prescriptions are generally intended for implementation over the next five years, the suggested Framework Agreement could serve as a model for increased co-operation throughout the next decade.

March 1989

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ACKNOWLEDGEMENTS

During the research and preparation of this Joint Final Report on the ASEAN-U.S. Initiative (AUI), the co-ordinating Institutes received valuable assistance from several individuals and organizations, and they would like to record their appreciation of such assistance. In particular they are grateful for the advice and guidance of the U.S. AUI Steering Committee, led by Allen Wallis, Under-Secretary of State for Economic Affairs, Department of State, and William Piez, Deputy Assistant Secretary for East Asian and Pacific Affairs, Department of State; the ASEAN AUI Steering Committee, chaired by Mr Ridzwan Dzaifir, Director-General, Singapore Trade Development Board; and the ASEAN Secretariat, especially its Secretary-General, Mr Roderick Yong, and Mr Chen Jin Fo. They would also like to thank the staffs of the Resource Systems Institute, East-West Center, the Institute of Southeast Asian Studies, and the Thailand Development Research Institute (TDRI) for all their help in the preparation and completion of this Report. They are also indebted to all the participating ASEAN and American researchers for their valuable contributions and promptness in meeting seemingly unreasonable deadlines. Last but not least, the co-ordinating Institutes wish to record their gratitude to the United States Agency for International Development (USAID) for its financial support of the U.S. portion of the study on the AUI, and the United Nations Development Programme (UNDP) for meeting the costs of the ASEAN segment. With regard to the latter the assistance of Mr Andrew Joseph, Mr Galal M. Magdi, and Mr Sebastian K. Zacharia is most appreciated.

This *Joint Final Report* has been prepared under the overall guidance of the Resource Systems Institute, East-West Center, Honolulu, and the Institute of Southeast Asian Studies, Singapore, the two co-ordinating Institutes for the AUI Study for the United States and ASEAN, respectively.

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EXECUTIVE SUMMARY

INTRODUCTION

As part of their development effort, the ASEAN countries place increasing emphasis on intra-regional economic co-operation. They also act as an economic bloc in multilateral negotiations. ASEAN has seven dialogue partners: the United States, Japan, the European Communities (EC), New Zealand, Australia, Canada, and the United Nations Development Program. The ASEAN-U.S. Initiative (AUI) stems from the economic dialogue and is designed to enhance bilateral economic co-operation. This study on the AUI was commissioned in July 1988.

Both the ASEAN countries and the United States have achieved solid rates of economic growth in recent years. Singapore, Malaysia, and Thailand have exhibited high growth rates; Indonesia has coped well with the fall in oil prices, diversifying its economy away from nearly exclusive reliance on oil, as Brunei Darussalam is beginning to do. The Philippines has rebounded from the slump of the 1983-86 period. The United States is experiencing its longest peacetime economic expansion, now into its seventh year.

The relationship between the United States and ASEAN is growing in importance. In the past ten years, ASEAN trade with the United States more than doubled. The United States is now ASEAN's largest export market and its second largest source of imports, after Japan. At the same time, the composition of this bilateral trade is changing. Although ASEAN remains a major supplier of primary products, over 36 per cent of U.S. imports from ASEAN are manufactured goods. The growing trade relationship is paralleled by expanded U.S. investment in the region. The rate of increase in U.S. direct investment to ASEAN over the past decade has been double that to any other country, with the stock reaching more than US\$10 billion in 1987. There is evidence that actual direct foreign investment (DFI) is substantially larger than the reported figures indicate.

Trade in goods and services between the United States and ASEAN are considered in Chapters 2 and 3, respectively, of the report. Chapter 4 addresses the intellectual property rights issue. This is followed by a review of U.S. investment in ASEAN in Chapter 5. The medium- and short-term economic outlook for the United States and ASEAN are examined in Chapter 6. Finally, Chapter 7 presents recommendations for a Framework Agreement between ASEAN and the United States.

TRADE IN GOODS

Most ASEAN members depend on exports as a major source of income, ranging from more than 130 per cent of GNP for Singapore to 23 per cent for the Philippines. And the most important destination of these exports is the U.S. market. The increased reliance on trade is the outcome of outward-looking development strategies, involving structural changes based on the countries' comparative advantage. As a result of industrial restructuring, the commodity structure of ASEAN-U.S. trade has changed in recent years. The promotion of manufacturing as an essential ingredient in the development strategy plays an important role in this change. Though labour-intensive manufactures and food processing remain large, the ASEAN countries are starting to turn towards industries with higher value added. The decline of world primary commodity prices also intensifies the structural change.

The United States ranks first in bilateral trade with Singapore and the Philippines while Japan ranks first with other ASEAN members. U.S. imports from Brunei Darussalam, Indonesia, and Thailand have increased significantly in recent years. The relatively free access to the U.S. market, compared with that in Japan and the EC, coupled with the increased export orientation of the ASEAN economies, has underlined the importance of the United States for the economic future of ASEAN. This dependence is especially pronounced in the case of manufactured exports. The United States is not dependent on ASEAN to the same degree, but it is seeking to expand its exports to this fast-growing market with which it currently has a US\$8 billion trade deficit.

The U.S. and ASEAN economies are complementary in nature. ASEAN is a large exporter of petroleum, rubber, sugar, and tin, while the United States is a net importer of these goods. The trade patterns for manufactures reflect the factor and technology endowments of the respective countries. The ASEAN countries are competitive exporters of labour-intensive manufactures such as textiles, garments, handbags, and other light consumer manufactures. The United States is a large net importer of these goods. In turn, the United States is a large producer of capital- and technology-intensive goods such as chemicals, electrical and non-electrical machinery, and transportation equipment, while the ASEAN countries are primarily net importers of these items.

The exception is electrical machinery where a significant amount of intra-industry trade takes place, as many U.S. multinational corporations (MNCs) have subsidiary plants in the region. While there is a potential for significant increases in U.S.-ASEAN trade, Japan and increasingly the Asian Newly Industrialized Economies (NIEs) are strong competitors in most products of interest to U.S. exporters.

There is a danger that the intensified trade relations could be halted by rising U.S. protectionism or inward-looking policies in ASEAN. While tariffs in the United States are low and the U.S. market continues to be one of the most open in the world, it has used in recent years voluntary export restraints to protect certain (mainly labour-intensive) industries. High trade deficits, coupled with the perception that the United States is fighting with "one hand tied behind its back", have encouraged protectionist sentiments. The U.S. Government has been largely successful in resisting demands for increased protection, but this stand is losing popularity. The U.S. trade deficit should not be addressed by trade barriers, which lead to decreases in domestic and global welfare; it should be reduced through rational macroeconomic policies at home, increased competitiveness of U.S. exports abroad, and more rapid opening of foreign markets to U.S. exports. Trade barriers in ASEAN are significantly greater than in the United States, and much work remains in further liberalization. These barriers include high tariff levels in most ASEAN countries, import licensing, and various quantitative restrictions. Yet, the ASEAN countries have undertaken unilateral trade liberalization in the 1970s and 1980s. It is desirable for domestic and international reasons that these policies be continued and trade liberalization carried further.

Both the United States and ASEAN are dedicated to the success of the Uruguay Round of GATT negotiations. Both have already demonstrated a potential to work together, especially on agricultural trade issues.

Despite more than ten years of negotiations, the trade impact of ASEAN economic co-operation has not been substantial. The high economic and export growth rates in the region in the 1970s cannot be directly attributable to the ASEAN Preferential Trading Arrangements (PTA). In fact, it is estimated that only 5 per cent of the trade within ASEAN is covered under the PTA. None the less, significant improvements in the PTA were made at the Third ASEAN Summit, including a programme to place 50 per cent of the total intra-ASEAN trade under the PTA within five years. The ASEAN Industrial Joint Ventures (AIJV) programme was also expanded; it now allows for 60 per cent foreign participation.

In sum, the ASEAN-U.S. economic relationship in trade in goods is strong and strengthening. However, there remains much work to be done before it reaches its vast potential. Liberalization of trade barriers, promotion of efficient production, greater information on export opportunities in each other's markets, and expanded participation at the Uruguay Round of GATT to reduce direct and indirect barriers to global trade are in the interest of all.

TRADE IN SERVICES

Services trade now accounts for about a third of world trade. U.S. exports of private services (travel, transportation, royalties and fees, banking, and other miscellaneous private services) increased more than fivefold since the early 1970s to more than US\$57 billion in 1987. A similar increase took place in U.S. imports of services, which amounted to US\$56 billion in 1987.

ASEAN's service-sector trade has been growing as well. Since 1976 ASEAN exports of service have quadrupled to over US\$11 billion. The Philippines, Thailand, and especially Singapore had surpluses in service transactions in the 1980s. There are, however, many problems involved in addressing trade in this sector. Most fundamentally, there is no clear definition of what the service sector is and data are very difficult to obtain. In addition, trade in services is closely tied to investment in services. In most service industries, including banking, production and consumption occur at the same time and place. Therefore any discussion of service-trade liberalization must include some liberalization of investment in this sector as well. This has been an extremely contentious issue to most developing countries, which worry about domestic sovereignty, national security, and protecting fledgling service-sector industries.

Important barriers to services in ASEAN include (1) restricted access to markets in services; (2) leasing restrictions; (3) motion picture limitations; (4) limited foreign ownership of banking; (5) advertising restrictions; and (6) preferential treatment of domestic transportation. Many of these barriers are investment-related in the sense that they constitute obstacles to establishing and operating affiliates in host countries. Significant efficiency gains have been realized in the United States from deregulating certain service industries, and ASEAN could benefit from a similar action, especially in the information sector. Moreover, ASEAN would increase efficiency and attract larger amounts of foreign investment by relaxing foreign equity controls. Services in the United States are generally free of barriers at the federal level, although there are some restrictions at the state level. The United States has been criticized for certain antitrust laws which inhibit international trade, as well as a lack of U.S. export consciousness. Improvements in these areas would facilitate trade in services as well as goods.

We recommend that ASEAN liberalize the service sector to facilitate export-oriented growth. Liberalization and deregulation would also enhance market incentives and allocative efficiency, thereby strengthening the dynamism of the ASEAN economies.

INTELLECTUAL PROPERTY RIGHTS

Protection of copyrights, trademarks, patents, and trade secrets has been a contentious issue in the Uruguay Round. The United States has pressured several ASEAN countries to tighten their intellectual property laws and to

increase their enforcement efforts, and threatened retaliatory measures against developing countries that fail to do this. Moreover, it has emphasized the long-run benefits of increasing intellectual property protection to encourage domestically generated innovations. For their part, some ASEAN members believe that in demanding intellectual property rights protection, the United States is intruding on their sovereignty and is not sensitive enough to their development needs. Others insist that they have already legislated sufficient protection. The ASEAN countries have responded differentially to American pressure in terms of *de jure* laws and actual enforcement, reflecting the diverse nature of ASEAN. All of them have improved protection of intellectual property to conform more closely to international standards. Indonesia made major improvements in protecting trademarks and copyrights, is considering joining one of the two international copyright conventions, and is negotiating with the United States on a bilateral copyright agreement. Malaysia has greatly strengthened legislation protecting intellectual property and is negotiating a bilateral copyright agreement with the United States. The Philippines is a signatory of both the Paris and the Berne Conventions. Thailand is in the process of changing its laws to conform to modern commercial practices world-wide; it is already a signatory of the Berne Convention. Singapore strengthened comprehensive laws protecting intellectual property. However, the enforcement of intellectual property rights has been inadequate in some ASEAN countries.

In sum, the ASEAN countries' protection of intellectual property has improved considerably. Nevertheless, the United States continues to be dissatisfied with some aspects of ASEAN intellectual property protection, for example, in pharmaceuticals and computer software.

As ASEAN improves its protection of intellectual property, it will benefit from increased foreign investment and technology transfer, as well as greater incentives to indigenous technological development. If intellectual property is not adequately protected, the country will be deprived of cutting-edge technologies, products and techniques, as well as risking continued frictions with innovation-exporting countries.

For its part, the United States should concentrate its efforts on developing broader international standards and should continue to improve its own system of enforcing intellectual property rights. U.S. accession to the Berne Convention was a step forward.

INVESTMENT

The chapter on investment in this report concentrates on direct foreign investment (DFI), even though DFI constitutes a relatively small share of total capital flows. This is because DFI is important in the development process. Along with Japan, the United States is the most significant source of DFI in ASEAN. U.S. DFI is concentrated in petroleum and electronics. High

rates of return to DFI in ASEAN, stable political environments, economic robustness, low-cost of indigenous labour, large markets, and an atmosphere conducive to foreign business are the attractions for U.S. investment. U.S. firms have not been found to have responded significantly to investment incentives. An area in which U.S. capital may be able to play a somewhat greater role in the future is in service industries such as trade, banking, and finance.

In any case, U.S. DFI in ASEAN has become increasingly important in the 1980s, accounting for more than 3–5 per cent of total U.S. investment. But Japanese investment in the region, as elsewhere, has been growing more rapidly. This trend is also likely to continue given the large Japanese trade surplus. The Japanese have been very successful at their attempts to blend official development assistance with private-sector projects in a way in which the United States has not attempted.

U.S. DFI in ASEAN has obviously been of benefit to U.S. firms and contributes to the U.S. economy. At the same time, it benefits ASEAN nations in a number of ways, by (1) providing access to modern and efficient management techniques; (2) facilitating the transfer of technology in production, management, marketing, and other intangible assets; (3) training the indigenous labour force for high-skill jobs; (4) providing needed foreign exchange; (5) providing jobs, especially in manufactures; and (6) engaging significantly in international trade. The dynamics of industrial restructuring (along the lines dictated by comparative advantage) attendant upon DFI may be the most important beneficial consequence for ASEAN in the long run. On the other hand, DFI in ASEAN that depends on tariff barriers erected for sectors with comparative disadvantage can inhibit long-run economic growth by drawing resources into inefficient industries.

Aspects of U.S. policy that might be promoted to increase DFI to ASEAN, include (1) more rational taxation measures; (2) relaxation of international trade and strategic trade controls; (3) more comprehensive information on DFI opportunities, especially for small- and medium-sized firms; and (4) further revision of the Foreign Corrupt Practices Act.

At the same time, ASEAN can reduce certain impediments to DFI including (1) lack of infrastructure; (2) performance requirements; (3) bureaucratic red tape; (4) trade restrictions; and (5) equity restrictions.

ASEAN governments should provide more business infrastructure. This is an important consideration in a firm's plans to invest in a particular country. In some cases, it may even be possible to solicit foreign involvement in the infrastructure development projects themselves. Moreover, the achievement of a more regional ASEAN market through improvements in the ASEAN PTA, and the possibility of greater foreign involvement in AIJVs should also increase the flow of foreign investment.

Complicated and restrictive performance requirements, equity restrictions, and extensive bureaucracy are widely acknowledged to be the greatest barriers to DFI in ASEAN. In addition, because these requirements vary considerably within ASEAN, many U.S. firms, particularly small- and medium-

sized enterprises, find it difficult to take a regional approach to investment in ASEAN. A common set of general DFI guidelines would greatly facilitate this process. A Bilateral Investment Treaty between the United States and ASEAN would be an effective way of achieving this goal.

The United States and ASEAN could jointly implement a number of measures to promote greater flows of DFI as well as increase benefits from existing investments. For example, the United States and ASEAN should work together to increase the supply of information. Although the U.S. Government supplies a considerable amount of information on investment opportunities in ASEAN, it appears that the use of such information is limited. The government or business organizations, such as the Chamber of Commerce, could expand efforts to disseminate information on ASEAN investment opportunities. Furthermore, ASEAN governments also provide a substantial amount of information, but accessibility could be improved. Governments will have to bear partial responsibility in making improvements in the distribution of this public good, although it is clearly in the interest of business organizations to assist such efforts wherever possible since their members will be the primary beneficiaries. Hence, the establishment of an institution, initiated through public action but financed through private means, that could provide information dissemination and a channel for co-ordination of U.S. investors, especially for small- and medium-sized firms, could be an important catalyst in shifting the orientation of American firms towards the Asia-Pacific in general and ASEAN in particular.

The growth in importance of the U.S. Overseas Private Investment Corporation (OPIC) in the mid-1980s is impressive and increased OPIC activity is likely to assist in the advancement of DFI as well as forge a closer relationship between the U.S. Government and U.S. private firms interested in making foreign investments. It is also possible that special incentives designed to redirect factors of production away from inefficient industries could be beneficial. If well conceived, such schemes could promote more efficient rationalization of production capacity in activities where the United States is clearly losing comparative advantage. This principle extends to the ASEAN economies as well.

U.S. AND ASEAN ECONOMIC OUTLOOK

Led by robust growth in the United States, the world has experienced an uninterrupted period of expansion since 1983. Annual growth in global real GNP in the period 1983–87 averaged 3.3 per cent.

While developing countries are expected to grow at 3.9 per cent in 1988–89, Asian developing countries should grow at about 7 per cent. Associated with the growth of the global economy has been an annual expansion of 6 per cent in the value of world trade in the last three years.

Although the prospect for world growth in the near future is good, there

are several uncertainties. First, the "twin deficits" in the United States are expected to continue well into the 1990s, as a revised Gramm-Rudman-Hollings amendment allows. The trade deficit has improved in 1987-88 but remains well above US\$130 billion. Capacity constraints could slow export growth and lead to higher inflation. The ASEAN countries continue to depend on oil and other primary commodities for the bulk of their exports, and the price prospects of these are not clear at this time. The global debt crisis continues to plague many countries in the developing world, including the Philippines, as well as financial institutions in the developed world.

In the medium run, the U.S. outlook is dominated by several factors. First, there is declining labour force growth, which is likely to lead to an improvement in the domestic investment climate, a gradual revival of productivity growth, and consequent rebuilding of U.S. competitiveness. Household and business savings may increase because of positive demographic changes and possible tax revisions to encourage saving. Without adequate domestic saving, the need to rely on capital imports to finance investment would place intolerable burdens on the balance of payments. The second major consideration is the U.S. budget deficit, which must be progressively lowered to restore the confidence of financial markets and reduce the need for foreign capital. Thirdly, the international debt crisis remains a critical problem. A viable resolution of this debt crisis will include a return to better economic growth in debtor countries, which will in turn benefit the United States.

The U.S. outlook for the next twelve to fifteen months is continued expansion amid increased uncertainty. As of December 1988, the consensus forecast was for real output growth of approximately 3 per cent in 1988 and 2.5 per cent in 1989. Evidence that the economy performed more strongly than expected in the first half of the year is causing analysts to revise their forecasts. Recent forecasts placed inflation in the neighbourhood of 4 per cent in 1988 and 4.25 per cent in 1989. The outlook for employment remains strong. Unemployment should continue in the range of 5.4 per cent for much of the next twelve months, barring any major policy shocks. The current account deficit is expected to run at approximately US\$150 billion in 1988 and fall to US\$130 billion in 1989. The trade balance should be in deficit of about US\$135-140 billion in 1988 and of US\$120 billion in 1989.

The ASEAN countries are expected to continue their robust economic growth through 1989, outpacing the world average. Inflation rates are expected to be moderate, and the restructuring of many ASEAN nations towards more open and increasingly private economies should continue. However, the debt and unemployment problems in some ASEAN countries, as well as political instability, continue to exist. ASEAN nations will replace the Asian NIEs in a broad range of product areas. There are promising opportunities, provided that trade frictions can be avoided. One way to do that is for both sides to make certain that market access remains open so that mutually beneficial two-way trade can develop. It is especially important that channels for intra-industry trade be developed and expanded.

Because economic growth in ASEAN is closely linked to growth in the OECD countries, optimistic forecasts of OECD growth are welcome. Singapore, Thailand, and Malaysia may attain high annual growth rates of about 7 to 9 per cent in the short run, while real GDP growth for the Philippines is expected to remain at around 6 to 7 per cent. As for Indonesia and Brunei Darussalam, the corresponding rates are projected to be around 4 to 5 per cent annually. These projections are likely to be valid also for the medium term, with ASEAN remaining one of the most dynamic regions in the world.

RECOMMENDATIONS FOR AN ASEAN-U.S. TRADE AND INVESTMENT AGREEMENT

Based on our findings and arguments, it is desirable that ASEAN and the United States consider entering into an economic co-operation agreement. It should consist of a general umbrella agreement which would have provisions for more specific bilateral arrangements. Within the scope of such an agreement, the United States and ASEAN would be able to negotiate a wide range of formal agreements, ranging from formal comprehensive treaties to sector- and issue-specific arrangements. The umbrella agreement would become an important catalyst for increased trade and investment between the two parties, and would also provide for negotiations between the United States and individual ASEAN nations.

Recommendations for an Umbrella Agreement

The umbrella agreement should include characteristics of other successful bilateral pacts by focusing on trade and investment liberalization and promoting economic welfare and efficiency, and should serve as a model for similar arrangements with other nations in the Asia-Pacific region. Yet, an ASEAN-U.S. agreement would be unique, as the ASEAN-U.S. economic relationship is unique. The complementary nature of the U.S. and ASEAN economies and the extensive economic interchange suggest that bilateral agreements under the umbrella designed to resolve any disagreements or seize important opportunities would be welfare-enhancing, without contradicting multilateralist ideals. Indeed, all actions would be consistent with GATT.

The initial umbrella should consist of the following components. First, it should establish a set of basic guiding principles for the conduct of trade and other economic relations between the United States and ASEAN, based on GATT compatibility and affirming the primacy of multilateral liberalization. It should be grounded on the presumption that trade and investment flows are determined by market forces as much as possible; the nature of government intervention should be strictly defined and temporary. Most basically, the United States and ASEAN should commit themselves to the principle of "stand-still and roll-back" of trade barriers. Moreover, measures harming other trading partners should be avoided.

Second, the umbrella should establish the administrative and implementing guidelines for the United States and ASEAN negotiating a series of subsidiary agreements on subjects such as subsidies, double taxation, intellectual property rights, investment, services, non-tariff barriers, and safeguards, supplemented by more detailed accords where needed.

Third, the umbrella should delineate effective procedures to administer the agreement and resolve disputes in a timely and efficient manner.

Fourth, it should create a Consultative Committee, composed of government representatives at the level of trade minister and advised by experts and private-sector representatives, which should meet at least on an annual basis. The Consultative Committee would have several important tasks. It should be responsible for considering trade and investment disputes in a manner defined by the umbrella agreement. Also it should oversee the negotiations of the subsidiary agreements, and should serve as a forum for moulding joint ASEAN-U.S. positions on these issues at the current and subsequent GATT rounds. Moreover, the Consultative Committee should authorize the preparation of studies, formation of working groups, and other vehicles for improving understanding of and co-operation in bilateral economic relations.

Fifth, the umbrella agreement should lay the foundation for further bilateral and multilateral co-operation.

Possible Trade and Investment Pacts under the Umbrella

After the establishment of the umbrella agreement, the United States and ASEAN could negotiate a series of bilateral pacts, from a formal free-trade agreement (FTA) to sector-specific agreements. In this section, we assess some of the available options which the Consultative Committee should consider. However, the list is not exhaustive. Many of the issue-specific topics are being considered at the Uruguay Round. Nevertheless, bilateral ASEAN-U.S. trade and investment agreements could complement the GATT talks and, perhaps, provide an exemplary framework in certain areas.

ASEAN-U.S. Free-Trade Agreement

We believe that an ASEAN-U.S. FTA should be the ultimate goal of the Framework Agreement. An ASEAN-U.S. FTA would be very complex and is likely to take a long time to negotiate. However, there is great potential for improved trade and investment relations in such a pact. Commissioning a comprehensive study should be among the first inquiries the Consultative Committee should launch.

The conformity of an FTA with GATT rules is clearer than with any other option. Free-trade agreements have come to mean far more than merely reducing internal tariffs on trade in merchandise. As in the U.S.-Canada agreement and the Closer Economic Relations pact between New Zealand and Australia, trade in services, investment liberalization, protection of intellectual property, and so forth, are often included. Similarly, an FTA between